AEROSPACE INDUSTRIES ASSOCIATION

November 14, 2003

Defense Acquisition Regulations Council
Attn: Mr. Steven Cohen
OUSD (AT&L) DPAP (DAR)
IMD 3C132
3062 Pentagon
Washington, DC 20301-3062

Dear Mr. Cohen:

The Aerospace Industries Association appreciates the opportunity to provide comments on the proposed amendment to the Defense Acquisition Regulation Supplement (DFARS) to eliminate government source inspection requirements for contracts or delivery orders valued below $250,000 (DFARS Case 2002-D032). While we understand the need for the conservation of scarce government resources, we have strong objections to these changes and recommend that its implementation be delayed until there is a full implementation of Wide Area Workflow (WAWF) or January 1, 2005, whichever occurs first. We have outlined below a number of specific issues our members have with the proposed rule and underlying policy change.

a. *Criteria for determination*

As addressed within recent internal Department of Defense guidance and DCMA briefings, the Office of the Secretary of Defense (OSD) has directed that Service Procuring Contracting Officers (PCOs) have the responsibility to identify all qualifying parts moving from source to destination acceptance. To define the "Universe" of affected parts, PCOs will undoubtedly turn to DCMA, contractors and suppliers for their technical recommendations. To determine eligibility for exemption under DFARS 246.402, "Government Contract Quality Assurance at Source," technical part-by-part research and evaluations will be needed to be performed. Thorough analysis will require the participation of the Services, DCMA and Contractor/Supplier, in-house organizations and resources including but not limited to Engineering, Finance, Supplier Management & Procurement, Product Support and Information Technology. To determine eligibility, this multi-function, resource intensive evaluation must be performed on each contract, each order and each part. Conceivably the combined effort of these various organizations would equal or exceed the resources being saved by elimination of source inspection. This does not appear to be a cost effective use of these resources.

The "critical product feature/characteristics" criterion for determining if source inspection is justified is undefined. OEMs identify in their drawings the characteristics a product must meet to be acceptable, and may identify what they believe are the most important characteristics, but it

is unclear if the term "critical product feature" would have a common meaning across the DOD supplier base. This issue is particularly important since source inspection cannot be specified unless the item meets all three criteria. Confusion over criteria at 246.402 (3) (ii) will make application of the proposed rule difficult, or at least inconsistent across suppliers and Contract Administration Offices. For example, if a contractor sells a product applicable to a variety of jet engines to all three Services and DLA, each buying activity could read the criteria differently and take a different approach to the inspection of the item. This would lead to increased administrative burden on both the contractor and government.

It is unclear why both 246.402 (3) (i) and (ii) must both be met. If the contract specifies a "technical requirement," and the government desires to have any inspection done on the item, then the inspection should be done by the government activity most familiar with the technical requirements of the product and the manufacturing processes used to produce the item. If the technical requirements are so important that the government chooses to specify those requirements in the contract (through technical documents, specifications, drawings, etc.), then those requirements should be adequate justification for authorizing source inspection without having to take the extra step of determining if those technical requirements also specify "critical product features."

We recommend combining (i) and (ii) to read "(i) Contract technical requirements are significant (e.g., the technical requirements include drawings, test procedures, characteristics that are critical to proper performance of the item are identified, specific concerns have been identified with regard to the contractor's ability to meet the technical requirements, etc.)."

b. *Mixed Inspection/Acceptance Processes on Contracts*

DOD has moved towards the use of Corporate Contracts for procuring spare parts from large OEMs. These contracts are typically ID/IQ contracts where the government places individual orders for specific items. Because of the wide range of items being procured under these contracts, it is very likely that some of the orders placed by the government may not meet all three criteria contained in the proposed rule. We believe it would cause tremendous confusion with both the supplier and the resident Contract Administration Office if some orders under a given contract called for source inspection and others called for destination inspection. This comment applies to the proposed language at both 246.402 and 246.404. We recommend that this situation be explicitly addressed in the final rule.

c. *Relationship to DCMA In-Process Inspection*

Today, DCMA largely does process inspections rather than individual inspections of the product itself. Where the government retains an in-plant office that has oversight of the contractor's processes, it is not cost effective to have any of the hardware produced by that process inspected at another location by another organization. Oversight of the processes and sample inspections of product produced by the process must go hand in hand. Plants with in-process inspections should be exempt from this policy change.

If plants with in-process inspections cannot be exempted, then DCMA must ensure that only those future contracts/POs specifically designated by the contracting officer will get destination inspection. Contracts already in process should continue to receive source inspection unless the contracting officer modifies the contract. This should be made explicit in the final rule to avoid confusion among buying and contract administration activities.

d. *Impact on Payment Process*

This proposed change will put revenue recognition at risk for many contractors. For example, in the case of one large contractor segment doing principally military work, 68% of its orders are under $250K. When orders go from source to destination acceptance, the segment will see a delay in the title transfer and therefore revenue recognition. AIA estimates that order-related sales and income reported on financial statements of our member companies would be adversely impacted by an income receipt of at least four or more days. Additionally, DoD's Wide Area Workflow (WAWF) program is not anticipated to be fully deployed to all Services until September 2004; thus, leaving DCMA and the military services with the potential requirement to develop service unique, non-standard inspection and acceptance processes in the interim for those activities not already accustomed to performing inspection and acceptance functions. This problem will be further compounded by the fact that before all the government receiving locations can electronically accept the order and move the acceptance into the MOCAS system, they will need to be trained on Wide Area Workflow (WAWF). Efficient processing of invoices is crucial for cash flow –the acceptance is the basis of the receiver/invoice match that must occur for payment. If the receiving locations are not capable of using WAWF, and must approve and distribute the DD250s manually, there will be real-time delays in payment.

With destination acceptance comes additional administrative burdens such as creating a process to ensure that contractor DD-250s shipped with the products are executed and returned in a timely manner so as to obtain the timely load of DD-250s into MOCAS. An average DD-250 submit-to-pay cycle time is estimated to be about 45 days for source acceptance using paper DD-250's and as little as 37 days if done electronically. It is likely that moving to destination acceptance will increase this cycle time by ten or more days. The full use of Wide Area Work Flow (WAWF) will not provide enough cycle time relief to counteract the added shipping time associated with destination acceptance shipments. Considering the volume of deliveries of products costing less that $250,000 that will be affected, we recommend implementation of the change in policy be deferred until WAWF is fully deployed by DCMA and all of the Services, or January 2005, whichever milestone occurs first.

In addition to the added cycle time, there is a high probability that destination inspection and acceptance will cause delayed payments and\or no payments because the receiving activity will either not execute the acceptance document promptly, not send it to the right activity for payment or not send it at all. This will result in increased contractor administrative costs as contractor staff is either reassigned or hired to untangle numerous additional payment issues which do not now exist. Government buying activities will be affected as they try to resolve these receipt problems. This will contribute to a further delay in payment for contractors in a time when cash flow is critical for all government suppliers. Along with new systems for just-in-

time inventory, our members are dependent on just-in-time payment from their customers. In addition there undoubtedly will be increased disputes between the government and industry and common carriers as claims are filed for goods lost, damaged or destroyed during shipment.

The change in policy is ostensibly based on a business case that in addition to recognizing the situation of declining human resources relies on a presumption that destination inspection for items of lower value is cost effective. To succeed, there needs to be an alternative to permit contractors to certify shipments for payment where circumstances dictate. Without some form of relief from the problems associated with destination inspection and acceptance, overall costs to the government will increase rather than decrease.

e. *Additional Costs/Risk of Loss*

In addition to payment delays, there is concern that the change to destination acceptance; FAR 47.302, "Place of Delivery -- F.O.B. Point" subparagraph (c)(1) would appear to change the F.O.B. delivery point to destination as well. This change shifts additional administrative costs, risk, and liabilities to the prime contractor and suppliers of DoD; specifically:

1. Contractors will be liable for any delivery, storage, demurrage, accessorial or other changes involved before the actual delivery;

2. The contactor must pack and mark the shipment prior to delivery; whereupon the destination acceptor will inspect, accept and may be required to re-seal and repack those goods dependent upon final destination of the parts;

3. Contractors are liable for any loss of and/or damage to the goods occurring before receipt of the shipment. This will result in increased insurance or liability costs. For some contractors, all items shipped and valued at $250,000 or below would be subject to the company's insurance policy deductible provisions and therefore the supplier would be faced with either absorbing those costs or developing a pricing factor to compensate for these losses. Repair or replacement costs would necessarily increase as responsibility for shipment is transferred to the contractor.

4. Contractors must bear all charges to the specified point of delivery. This regulatory change will cause an increase in the expense to prime contractors as almost all existing programs are all priced on the basis of FOB origin delivery. Shipping and handling charges are not currently part of these prices. Contracts will need to be modified to recognize these added costs.

f. *Need for Criteria for Eliminating Any Inspection*

While the proposed rule will result in the shifting of inspection and acceptance from source to destination, the question of whether or not ANY inspection is justified has not been addressed. The government's objective in this proposed rule would be better achieved if the proposed rule also specified when no government inspection (at source or destination) is appropriate, especially when the government already is performing in-process system approvals. We recommend that further consideration be given making this distinction in the final rule.

For the reasons cited above, we believe that institution of this change in policy will have a costly and detrimental effect on government as well as industry. Not only will there be increased shipping costs to the contractor, but there will also be a diminished cash flow as acceptance and approval of DD-250s are delayed or not executed. Secondly, since decisions to retain source inspection are to be made by the contracting officer and the same item may be ordered by several different contracting officers, there is a likelihood that there will be differing determinations made with regard to the need for source inspection – adding an added layer of government administrative review and resolution. Clarification of what constitutes a "critical product feature" is clearly needed to minimize this level of confusion.

Thank you for this opportunity to provide comments on this very important change in policy. We would be pleased to host a meeting of industry and government representatives to discuss our comments and assist in making the final rule as cost effective as possible. If there are any questions regarding our comments or if we can be of further assistance, please do not hesitate to contact the undersigned at (703) 358-1045 or sullivan@aia-aerospace.org.

Sincerely,

Patrick D. Sullivan
Assistant Vice President
Procurement and Finance